Supreme Court, U. S.
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CASE NO. 79-1884

in the

Supreme Court of the United States

OCTOBER TERM, 1979

STATE OF WISCONSIN,
STATE OF MINNESOTA,
STATE OF TEXAS, and certain designated classes of consumers,

Petitioners,

v.

MELVIN REESE, a trustee in bankruptcy for KENNEDY AND COHEN, INC., and related subsidiary corporations, bankrupts,

Respondent.

On Petition for Writ of Certiorari To The United States Court of Appeals For the Fifth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether, as contemplated by U.S. Sup.Ct. Rule 19, 28 U.S.C.A. 37, there is any special or important reason for granting a review.

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STATEMENT OF THE CASE

The essential facts are set forth in the Partial Summary Judgment entered in the Bankruptcy Court (App. at A-12 to A-14). While not necessarily relevant, the additional facts set forth in the Petition were probably supported by the record below except for the assertion on Page 8 of Petitioners' Brief that:

> "Kennedy and Cohen did not set aside the preventive maintenance proceeds or any other funds or take any other measures to assure the performance of their service policy obligations."

While no funds were set aside, Kennedy and Cohen did use portions thereof to establish and maintain maintenance departments at various locations in several states, and in connection therewith, purchased and installed equipment, purchased repair parts and vehicles, made payroll of maintenance personnel and complied with the terms of the preventive maintenance contracts up until the date of bankruptcy.

ARGUMENT

A. No Constructive Trust Under State Law

In the Partial Summary Judgment, the Bankruptcy Judge clearly ruled that the Plaintiffs had failed to prove facts that would give rise to the establishment of a constructive trust under the laws of Texas, Minnesota, Wisconsin or any other state (App. at A-13 and A-14). Kennedy and Cohen had no duty under state law to set

up escrow or trust accounts for consumers. Accordingly, there was no wrongful act giving rise to a constructive trust. No assertion has been made by the Petitioners that the Court of Appeals, in affirming the lower courts, decided an important state question in a way to conflict with applicable state laws. No conflicting state law in this regard was cited, nor apparently does any exist.

Even though the Petitioners did not prove sufficient facts to impose a constructive trust under the laws of their respective states, they are petitioning this Court to consider whether bankruptcy law or state law should govern as to the extent of assets over which a constructive trust should be imposed.

B. Bankruptcy Law Controls Over State Law as to the Extension of a Constructive Trust to Unrelated Assets

If it is assumed, contrary to the facts, that a constructive trust would exist under the laws of the state of one of the Petitioners, then the question presented is whether, at some point, bankruptcy law should govern over other conflicting state law as to the extent of the bankruptcy assets over which the constructive trust may be imposed. The courts in *In re Faber's, Inc.*, 360 F.Supp. 946 (D.C.Conn. 1973), *Lusk Corporation v. Arizona State Tax Commission*, 462 F.2d 187 (9th Cir. 1972), and *Elliott v. Bumb*, 356 F.2d 749 (9th Cir. 1966), *cert. denied*, 385 U.S. 829 (1966), followed this Court's guidance in *United States v. Randall*, 401 U.S. 513 (1971), in recognizing that the Bankruptcy Act is an overriding expression of federal policy in this regard.

Respondent readily admits that this Court has recognized that a constructive trust imposed by state law will be recognized as to specific assets vested in a bankruptcy trustee. In this case, however, the Petitioners were unable to trace any assets, even with the presumptions recognized in *Cunningham v. Brown,* 265 U.S. 1 (1924). In lieu thereof, the Petitioners maintained that their inability to trace funds require the imposition of a constructive trust on all assets vested in the Trustee in Bankruptcy. No applicable state law affords them such a remedy. More importantly, there is no conflict between the decisions in *Cunningham v. Brown, supra,* and *United States v. Randall, supra,* or the cases decided thereunder. The cases relied upon by Petitioners, including *Cunningham,* relate to the tracing of funds to a bank account and not with the establishment of a trust where funds cannot be traced under any circumstances.

C. The Bankruptcy Act Has Been Replaced

The Bankruptcy Act of 1898, Ch. 541, §1 et seq., 30 Stat. 544 (1898) [Codified in 11 U.S.C. §101 et seq. (1970) (repealed 1979)], has been replaced in cases commenced after October 1, 1979, by the Bankruptcy Reform Act of 1978, 11 U.S.C. §101 et seq. (1979). Although no distinction was made between consumers and commercial creditors under the Bankruptcy Act, consumers are given a priority claim under the Bankruptcy Reform Act of 1978. *See Bankruptcy Code 11 U.S.C. 403(a)(5).* Although many cases are still pending that were commenced prior to October 1, 1979, their number and importance are dwindling. It is doubtful that a decision by this Court would substantially affect the rights of consumers in other pending cases.

Although not an issue here, at some time this Court will be asked to decide whether the priority given consumers under the Bankruptcy Reform Act supersedes the right of a consumer under state law to establish, in an appropriate case, a constructive trust over assets in the hands of a Debtor or Trustee.

CONCLUSION

The Petitioners did not establish their right to cause a constructive trust to be imposed upon assets vested in the Trustee in Bankruptcy. As recognized by the Bankruptcy Judge, it is the Plaintiffs' burden to establish some wrongdoing on the Bankrupt's part, either in obtaining funds or in retaining them (App. at A-13). The Plaintiffs could cite no state law that would have required Kennedy and Cohen to segregate or place in trust payments made by its customers on account of preventive maintenance policies.

The Petitioners admitted below that funds paid to Kennedy and Cohen could not be traced, and they made no effort to utilize presumptions in their favor to do so. Rather, they sought the imposition of a constructive trust upon all assets in the hands of the Trustee, including those encumbered by various security interests.

The question of whether bankruptcy law or state law should govern is academic in this instance since there is no basis under either law to sustain the contentions of the Petitioners. The lower courts properly relied upon the bankruptcy law to defeat the contention of the imposition of a general trust upon all assets. They

were not concerned with the extent to which an alleged trust beneficiary must trace funds into a bank account, since it was conceded that the funds could not be traced.

While the courts and legislatures of the various states have not seen fit to give consumers a preferred status over commercial creditors, the Bankruptcy Reform Act has now done so, thus leaving the absence of such distinction under the Bankruptcy Act of little public importance.

Accordingly, the Petition for a Writ of Certiorari before the United States Court of Appeals for the Fifth Circuit should be denied.

Respectfully submitted,

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